

# Commission Briefing Paper 5A-11

## Evaluation of Impact Fees and Value Capture Techniques

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### Introduction

This paper is part of a series of briefing papers to be prepared for the National Surface Transportation Policy and Revenue Study Commission authorized in Section 1909 of SAFETEA-LU. The papers are intended to synthesize the state-of-the-practice consensus on the issues that are relevant to the Commission's charge outlined in Section 1909, and will serve as background material in developing the analyses to be presented in the final report of the Commission.

This paper presents information on impact fees and value capture techniques as potential revenue sources for transportation investment. These potential revenue sources are described, examples are given, and the concluding section discusses the limitations of impact fees and value capture as a means of addressing the gap between transportation needs and available revenues.

### Background and Key Findings

Both impact fees and value capture mechanisms may be thought of as revenue generating tools that seek revenues from the beneficiaries and users of transportation improvements. There exists a rational nexus between the land uses that generate the traffic and the costs that arise to accommodate the traffic, and a rational nexus between increases in property value and new or enhanced transportation infrastructure. Historically, however, it has been difficult for state transportation agencies to seek revenues from either users or beneficiaries, since impact fees and value capture are often limited to local governments, and most highway and some other modal transportation needs and funding are often handled at the state level. In the past, such transportation amenities have been built with more broad-based revenues, and the legal authority and political support for obtaining revenue from users and beneficiaries has been difficult to obtain.

- An impact fee is a charge on new development to pay for the construction or expansion of off-site capital improvements that are necessitated by and benefit the new development.
- Value capture refers to the process by which all or a portion of increments (i.e., windfall gains) in land value attributed to "community interventions" (e.g., transportation improvements) rather than landowner actions are recouped by the public sector.
- Impact fees are intended to charge new users for the full costs of the infrastructure that they require.
- Value capture finances new infrastructure by charging the property owners and developers who benefit from increased property values created by the infrastructure
- There are three principal institutional arrangements that have been used to administer impact fees and value capture: (1) Transportation Development District - TDD; (2)

Transportation Improvement District - TID; and (3) Tax Increment Financing District - TIF.

- To date, 27 states have adopted impact fee enabling legislation, which apply to financing transportation improvements.
- Impact fees and value capture mechanisms have typically been imposed at the local level, while responsibility for many key transportation facilities lies with the state DOTs and other transportation agencies. Thus, impact fee studies sometimes do not address the full spectrum of transportation infrastructure needs, and revenues may not be provided to transportation agencies.
- The potential for using impact fees to finance transportation infrastructure is limited by the requirement for a rational nexus, proportionate share, and prompt use of proceeds.
- Impact fees may provide incentives for developers to focus efforts on areas that already have developed infrastructure, thus reducing sprawl and future needs for transportation facilities.
- Since some value capture mechanisms rely on estimates of future growth potential, they are considered a more speculative revenue source than many other types of revenues, and may incur higher financing costs if future revenues are bonded.
- Credit assistance programs from USDOT and states may be particularly applicable to lowering the financing cost of value capture projects that use debt financing..
- In many states, imposition of some value capture mechanisms requires the approval of a majority of the affected property owners; thus, building political support is essential.
- Building political support for value capture mechanisms may depend on documenting actual increases in property value experienced by property owners in other jurisdictions.

## **INTRODUCTION- DESCRIPTION OF IMPACT FEES AND VALUE CAPTURE**

An impact fee is a charge on new development to pay for the construction or expansion of off-site capital improvements that are necessitated by and benefit the new development. “Value capture” mechanisms seek to finance new transportation investments by capturing part of the increased property value that they can create.

Impact fees first came onto the scene in Florida and California during the late 1970s as a result of taxpayer revolts and reductions in federal and state aid for local infrastructure. Their use and popularity quickly spread throughout the Sunbelt and western states.

According to recent national surveys, about 60 percent of all cities with over 25,000 residents and almost 40 percent of all metropolitan counties use some form of impact fees. In California and Florida, the extent of cities and counties using impact fees is at 90 and 83 percent, respectively.

Value capture refers to the process by which all or a portion of increments in land value attributed to "community interventions" (e.g., transportation improvements) rather than landowner actions are recouped by the public sector.

Value capture opportunities capitalize the benefit of transportation investments and use that capital to fund portions of that investment. Value capture opportunities may be justified by the benefits that a transportation investment is widely regarded to generate, including:

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- Increased development (increased height or density allowances) that has been accommodated by increased access and mobility that otherwise could not occur
- Increased location value generated by an expansion of modal choice, creating a rent premium
- Reductions in auto ownership and parking as users are able to substitute transit for auto trips

Impact fees and value capture mechanisms are frequently applied and administered in transportation districts. Transportation districts are often concentrated in high growth areas and areas with redevelopment opportunities, although in some cases they have been used to provide basic infrastructure in new suburban areas. There are three principal district financing arrangements that have been used: (1) Transportation Development District - TDD; (2) Transportation Improvement District - TID; and (3) Tax Increment Financing District - TIF.

## **DESCRIPTIONS OF DISTRICT FINANCING ARRANGEMENTS**

### Transportation Development District -TDD

TDDs impose impact fees on developers or property owners for the cost of off-site transportation capital improvements needed to serve a new development. Impact fees provide up-front financing for the expansion of the transportation improvements. The fees are levied only upon new development or redevelopment of existing sites. Impact fees are a one-time assessment that may be paid in installments. The fee basis is traffic generated by the parcel. This is the most prevalent form of impact fee administration.

### Transportation Improvement District - TID

TIDs impose improvement fees on all property owners within the district. Although property values are used as the basis for assessments, the revenues generated are *not* considered ad valorem taxes or property taxes. Rather they are considered non-ad valorem assessments based on benefits to the property from district expenditures, because benefits are presumed to be proportional to property values, property values are a substitute or proxy for direct measurement of benefits generated. TID levies are recurring on an annual basis.

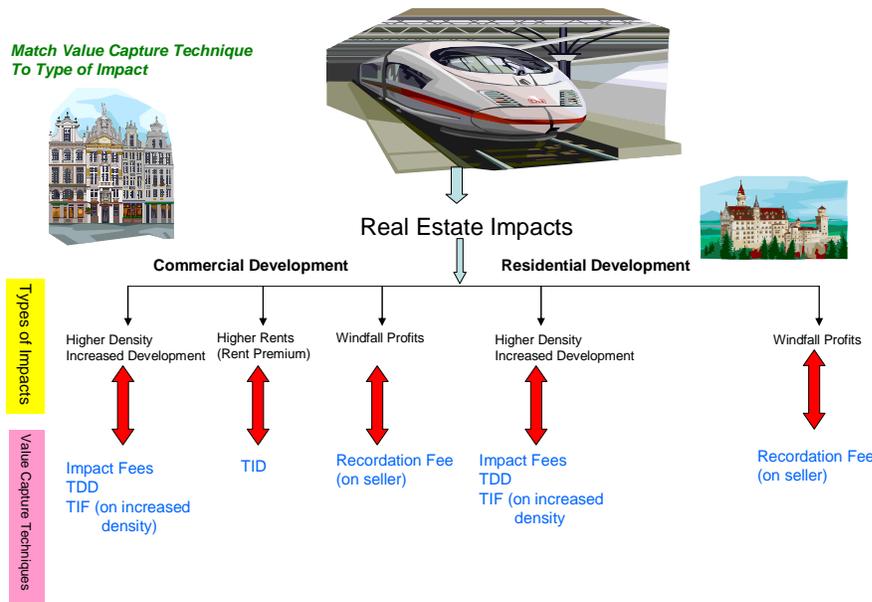
### Tax Increment Financing District - TIF

A tax increment financing district is a mechanism for capturing all or part of the increased value that occurs due to a transportation improvement. Under a TIF, part or all of future property taxes resulting from increased property values are used to pay for infrastructure, including transportation improvements in some cases.

TIF divides tax revenue from the area into two categories: (1) taxes on the predevelopment value of the tax base that are kept by each taxing body, and (2) taxes from increased property values resulting from redevelopment that are deposited (in whole or part) by each jurisdiction in a tax

increment fund and are used to finance public improvements in the redevelopment area. TIF does not impose an added tax burden upon property owners, nor does it deprive governments of existing property tax revenues. A TIF district acts as a value capture mechanism, whereby the increment in value credited to transportation improvements is negotiated and codified through a memorandum of understanding between the taxing jurisdiction (usually a city or county) and the transportation agency.

The schematic below shows the types of land use impacts generated by transportation investment and provides some guidance on the potential for “capturing” some of the beneficial impacts through different mechanisms.



## EVALUATION MEASURES

The three district models for financing infrastructure investments were compared using multiple criteria. A brief definition of each criterion follows below.

- **Properties Included:** defines which properties are regarded as participants in the financing arrangements.
- **Type of Levy:** defines the type of instrument that is used to raise revenue for funding transportation improvements.
- **Assessment Standard:** provides the measure that constitutes the tax base.

- **Legal Authority:** establishes the actions that must take place to create the district and impose the levy.
- **Recurrence:** timing regarding the imposition of the levy, e.g., one-time, recurring on a yearly basis.
- **Timing of Revenue:** timing of receipt of revenue, e.g., sporadic or periodic.
- **Burden:** extent of imposition among various property owners in a district.
- **Growth Potential:** ability of a levy to respond to growth in the economy and keep pace with the general rate of inflation.
- **Reliability/Stability of Revenue:** reliability of funding alternate to generate stable revenue stream over time that is not subject to major fluctuations.
- **Bonding Capacity:** ability of a revenue stream to be bonded to accelerate project implementation.
- **Administrative Requirements:** administrative capacity to create the structure and procedures necessary to levy and collect funds.

## **EVALUATION MATRIX**

An evaluation was prepared for the three models for district financing of transportation improvements. The evaluation was prepared to enable comparison of the three district models across criteria. This may be used by decision-makers to the process by identifying key criterion and assessing how the three district models compare. Once the transportation improvement program is specified and costed, and development potential is specified along with existing tax base data, financial analysis can be developed which tests the financial capacity of the three district models to fund the local portion of the transportation improvement program.

### **Summary of Characteristics by Type of District**

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CHARACTERISTICS	TDD	TID	TIF
Properties Included	Improvement to Vacant Parcels or Redevelopment	All Parcels All Improvements and May Include Vacant Land	Improvements to Vacant Land or Redevelopment
Type of Levy	Impact Fees	Property Tax Surcharge	Existing Property Tax
Assessment Standard	Traffic Generated	Property Value	Property Value Increases
Legal Authority	Local Ordinance	Vote By Property Owners in TID	Intergovernmental Agreement
Recurrence	One Time	Recurring	Recurring
Timing of Revenue	Sporadic - Depends on Development Activity	Periodic - Part of Annual Property Tax Collections	Sporadic – Depends on Development Activity
Burden	Future Development	All Present and Future Development	None - TIF Does Not Impose an Additional Levy
Revenue Growth Potential	Dependent on Economic Conditions and Local Real Estate Market	Responsive to Inflation	Dependent on Economic Conditions and Local Real Estate Market
Reliability / Stability of Revenue	Uncertain - depends on Pace of Development Cyclical - Follows Economic / Real Estate Cycles	Certain / Stable	Uncertain - Depends on Pace of Development Stable - Property Value Increase Locked-In

### Challenges to Using Impact Fees to Finance Transportation Infrastructure

Impact fees were pioneered by local governments in the absence of explicit state enabling legislation. Consequently, such fees were originally defended as an exercise of local government's broad "police power" to protect the health, safety and welfare of the community. The courts gradually developed guidelines for constitutionally valid impact fees, based on a "rational nexus" that must exist between the regulatory fee or exaction and the activity that is

being regulated. Texas adopted the first general impact fee enabling act in 1987. To date, 27 states have adopted impact fee enabling legislation (for other than water and wastewater fees). These acts have tended to embody the constitutional standards that have been developed by the courts.

In most states, impact fees must meet the "rational nexus" and "rough proportionality" tests. First, there must be a reasonable connection between the "need" for additional facilities and new development. Second, it must be shown that the fee payer will "benefit" in some way from the use of the fee proceeds. And third, calculation of the fee must be based on a proportionate "fair share" formula.

In the context of transportation facilities, these requirements can be difficult to satisfy, and can impose significant administrative costs. For example, additional traffic studies might be required to demonstrate how much residents of a new development will benefit from transportation facilities financed with impact fees. The rational nexus and proportionality requirements limit the ultimate revenue potential of impact fees.

Current practices, however, may fail to maximize the revenue potential. Since fees have traditionally been imposed at the local, not state level, impact fee analyses often do not account for the effect of new development on state-administered roads as well as local roads and other transportation facilities. In addition, it is much easier to create a rational nexus, and proportional share, for other kinds of infrastructure, such as wastewater, water, solid waste, and electricity, that new residents will definitely use, as opposed to the daily choices that must be modeled for transportation usage. If state as well as local transportation needs were included to a greater extent in impact fee analyses, more revenues might be dedicated to transportation uses.

Facilities eligible for impact fees include roads, water, sewer, storm water, parks, fire, police, library, solid waste, and schools. Roads are the only facility eligible in every state that has impact fee enabling acts.

The following table provides data on impact fees for roads by type of land.

	Single Family Unit	Multi-Family Unit	Retail Per 1000 SF	Office Per 1000 SF	Industrial Per 1000 SF
National Average	\$2,305	\$1,568	\$4,562	\$2,654	\$1,587
Sample Size	213	212	203	204	203
National Average w/o CA	\$1,930	\$1,322	\$3,774	\$2,177	\$1,348
Sample Size w/o CA	178	177	167	168	168

*Source: 2006 National Impact Fee Survey, Duncan Associates*

The impact fees for Single Family Unit are based on a typical three bedroom house of 2,000 square feet. For the Multi-Family Unit, the impact fee is on a per unit basis for a typical two bedroom unit of 1,000 square feet. Impact fees for retail, office and industrial are per 1,000 square feet for a typical 100,000 square foot shopping center, commercial building and industrial building, respectively. The data on impact fees are shown with and without inclusion of

California as impact fees for roads in California for a single family unit top out at \$17,754. The high for the remainder of the county is \$6,527.

### **Examples of Value Capture – Loudoun County Route 28**

Loudoun County, in partnership with Fairfax County, formed the Route 28 Highway Transportation Improvement District on December 21, 1987. Under Virginia law, such a district may be formed only upon the joint petition of owners of at least 51 percent of the land area in each county located within the boundaries of the adopted district, and which has been zoned or is used for commercial or industrial purposes.

The district was formed to provide improvements to State Route 28, which connects State Route 7 in eastern Loudoun County to U.S. Route 50 and Interstate Highway 66 in western Fairfax County, running approximately parallel to the county's eastern border. State Route 28 provides access to Dulles International Airport, along with the Dulles Access Road, which connects the Capital Beltway to Dulles Airport, and the Dulles Greenway, which provides highway access into central Loudoun County.

This district was formed upon landowner petition to accelerate planned highway improvements adopted by the state which relied primarily on slower pay-as-you-go financing from the Northern Virginia region's share of the state primary road fund allocation.

The district, administered by a commission appointed by the Boards of Supervisors of both counties, may subject the owners of industrial and commercial property within the District to a **maximum additional tax assessment of 20 cents per \$100 of assessed value**. These funds, in addition to funds received through the State Primary Road Fund allocation formula, are to be used for the road improvements and debt service on bonds issued by the state.

All debt issued by the state to fund road improvements to Route 28 was authorized during the 1988 Virginia General Assembly and became effective July 1, 1988. The Commonwealth of Virginia issued \$138.5 million in revenue bonds for the Route 28 project in September 1988.

Loudoun County and Fairfax County entered into a contract with the District on September 1, 1988, and agreed to levy additional tax assessments as requested by the District, collect the tax and pay all tax revenues to the Commonwealth Transportation Board. The contract specified that: (1) the County Administrator shall include in the budget all amounts to be paid by the county under the district contract for the fiscal year; (2) the county shall provide by February of each year the total assessed fair market value of the district as of January 1 of that year; and (3) the district in turn shall notify the county of the required payment and request a rate sufficient to collect that amount, up to a maximum of 20 cents per \$100 of assessed value.

Final figures based on the district request will be forwarded to the Board of Supervisors prior to their action. Initially, tax collections at the maximum amount were not sufficient to pay the debt obligation in full. Consequently, the difference has been made up from the Northern Virginia State Highway allocation. This process is expected to continue until such time as district revenues are sufficient to fund debt service costs in full.

## **Examples of Value Capture – Tri-Met Red Line to Airport**

The Portland area's award-winning MAX light rail system expanded to Portland International Airport (PDX) with service beginning on September 10, 2001. Continued passenger growth and limited road capacity at the airport set the stage for the project. The addition of a private funding partner helped propel the project forward. Light rail to the airport has been part of regional transportation plans and the PDX master plan since the mid-1980s. In 1997, Bechtel Enterprises came to the region and proposed a partnership allowing them to build the MAX extension in exchange for development rights to 120 acres owned by the Port of Portland at the entrance to the airport. Three local government agencies--the Port of Portland, TriMet and the City of Portland through the Portland Development Commission--capitalized on the private investment and the opportunity to extend light rail to the airport earlier than anticipated. In an innovative financing structure the unique public/private venture to finance Airport MAX used funds from local jurisdictions and agencies. No federal dollars, state general funds or additional property taxes were required. This accelerated the project timeline. The Port's \$28.3 million contribution was raised by bonding against a \$3-per-passenger facility charge. The City contributed \$23 million from an existing urban renewal district. TriMet contributed \$45.5 million in general funds and the sale of tax-exempt revenue bonds. The rights to the developable land valued at \$28.2 million--completed the project financing.

## **Challenges to Using Value Capture to Finance Transportation Infrastructure**

There are legal, financial, and political barriers to the use of value capture for financing transportation infrastructure. Since some value capture mechanisms rely on estimates of future growth potential, they are considered a more speculative revenue source than many other types of revenues, and may incur higher financing costs. If anticipated property value increases do not occur, the district or local government may not be able to repay debt issued. Thus, credit assistance programs from USDOT and states may be particularly applicable to lowering the financing cost of value capture projects in those cases where debt is issued backed solely by future revenue from the value capture mechanism.

Some states do not have authority to enact tax-increment financing, or impose severe limitations on its use. In many states, imposition of other value capture mechanisms, such as transportation development districts, requires the approval of a majority of the affected property owners; thus, building political support is essential. Building political support for value capture mechanisms may depend on documenting actual increases in property value experienced by property owners in other jurisdictions.

A more direct means of recapturing value is through joint development, such as air-rights leasing, ground leasing of adjacent agency-owned parcels, or station connection fees. Hong Kong's rail system covers all of its costs, including interest, from rents produced by land developments around stations and fare receipts. To date, U.S. transit properties have been far more timid in recapturing value, although a few are beginning to move aggressively in this direction. The historical lack of joint development activity in the U.S. could be partially

attributed to restrictive Federal rules hampering joint development or generation of income on Federally-assisted property. Over the past two decades, under Congressional direction, USDOT has modified its regulations and policies to facilitate increased revenue generation.

WMATA, which has one of the most effective programs (and continuous in terms of revenue generation) estimates value capture revenue through its joint development program at \$7,219,900 in the approved 2007 budget. This may be compared to the operating budget of \$1.15 billion, showing a contribution from value capture of less than one percent (0.63%).

One of the most direct means of recapturing value is through benefit assessments. Los Angeles's MTA obtained 9% of the funds used to pay for the \$1.5-billion Red Line subway through special assessments levied against owners of commercial properties in and around subway stations.

## **CONCLUSIONS**

Impact fees are mechanisms that can address a part of the needs associated with development-related growth, while value capture is a mechanism that can help finance and possibly create economic growth through charging the beneficiaries of new infrastructure. Yet the administrative requirements and restrictions imposed on the use of impact fee revenues may limit their overall potential for addressing transportation infrastructure needs.

Value capture, as was noted earlier, recoups the increment of value (windfall gain) from the transportation improvement that enhances specific land use parcels. For this to be a recurring feature in transportation finance, the value capture mechanism must be adopted and in place prior to the transportation improvement. There is no incentive for either the private sector party that receives the windfall gain or the public sector jurisdiction that reaps some benefit primarily through property taxes to share the gain with the transportation agency. The improvement already exists and is not going to be taken away, (i.e., transit agencies are not going to close stations, nor are highway agencies going to close interchanges, the locations that generate windfall gains to property owners and create value capture opportunities). While current use of value capture for transportation is sporadic, increased use might occur if legal, political, and financial barriers were overcome.